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DIRECTORATE OF  
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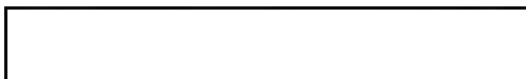
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State Department review completed

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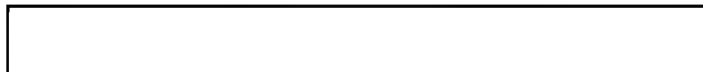
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WEST GERMANY: Defense Minister Schmidt has reaffirmed his demand that any agreement on mutual and balanced force reductions (MBFR) must include at the outset cuts in indigenous as well as stationed forces. Schmidt fears that if reductions in the West are limited to American forces, public demands for German cutbacks would ensue. He feels that the West German Foreign Office has given the impression that Bonn's position has softened in the last nine months to allow for an initial reduction of stationed forces only. He wants to reassert the emphasis on indigenous troop cuts now that exploratory MBFR talks are on the horizon. Schmidt hopes to forestall public demands for unilateral German cutbacks in defense spending and troop levels that the euphoria surrounding detente probably would engender. He also hopes to delay reductions in American forces as long as possible.

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EUROPEAN COMMUNITIES: EC finance ministers agreed last night to maintain their commitments to both the Smithsonian currency agreement and the EC narrow exchange-band system, despite the floating pound, by supporting the dollar and the lira. The possibility remains that if speculation against the dollar should continue at a heavy pace after EC markets are reopened on Wednesday, the ministers may yet be forced to adopt some stronger measures--such as currency floats or exchange controls. In order to preserve the arrangement that provides for EC member exchange rates to fluctuate within a band only half as narrow as that allowed outside the EC framework, special provisions were made for Italy, who had sought a temporary suspension of the EC band because of its weakened lira. Italy will be permitted to repay whatever debts it incurs in defending the lira with dollars up to 15 July. British Chancellor of the Exchequer Barber, who also attended the meeting, assured his colleagues of the Six that the UK intends to end its float as soon as possible, hopefully at the Smithsonian fixed rate, and return to the EC fold.

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